

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

PERIODIC REPORTING
(PROPOSAL ONE)

Docket No. RM2015-9

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
REGARDING PROPOSAL ONE
(August 3, 2015)

On June 12, 2015, the Postal Service filed a Petition seeking initiation of this proceeding to consider a proposal to modify Revenue, Pieces, and Weight (RPW) reporting procedures relating to forever stamp usage, the adjustments to the Postage-in-the-Hands-of-the-Public (PIHOP) liability, and “breakage” (the term for stamps that will never be used on mail pieces). Order No. 2545 (June 18, 2015) established July 23 as the date for the filing of initial comments by interested parties in this proceeding. The only initial comments filed by that date were submitted by the Public Representative on July 22, 2015. In accordance with Order No. 2545, the United States Postal Service hereby files its comments in reply to those submitted by the Public Representative.

The Public Representative offers different recommendations for what she considers to be separate components of the Proposal:

For the reasons the Postal Service stated, the Commission should adopt the Postal Services’ proposal to use ODIS-RPW estimates for products bearing forever stamps directly in the RPW. However, the Commission should deny the Postal Service’s proposal to remove the allocation of PIHOP adjustments to products. Additionally, the Commission should also deny the Postal Service’s proposal to allocate breakage from both forever and non-forever stamps to Market Dominant Other Revenue in the RPW report.

PR Comments at 2. Her recommendations, however, misconstrue the relationship between these components, perhaps based on a misunderstanding of the fundamental principle that RPW is intended to report product revenues, pieces and weight seen, recognized, or processed in the reporting time period. Her recommendation that the Commission bifurcate its treatment of components of Proposal One should be rejected.

To better explain why, and solely for purposes of illustrating the essence of the interdependent procedures involved, the Postal Service has constructed a simplified example that hopefully allows a better understanding of the details (including the relationships between sales, usage, breakage and Book Revenue Adjustment Factor (BRAFF)) within the current procedure and the proposed procedure. The example is presented in a spreadsheet (Reply.Cmmnts.Illustration.xls) attached to these Reply Comments electronically. Obviously, for purposes of this exercise, the illustration is highly streamlined, and does not purport to represent the full range, scope, and details of the actual procedures involved.

As the Commission is well aware, the Postal Service operates on an accrual accounting basis. Under this treatment, the revenue associated with stamp *usage* is of paramount concern, while the cash from stamp *sales* is not. The simplified example begins with \$1,000 of total trial balance revenue, \$56 of forever stamp sales, \$50 of forever stamp usage, and \$1 of breakage. Due to the fact that revenue from sales of forever stamps is \$5 more than usage of forever stamps plus breakage, the Postal Service must defer \$5 of cash collected and increase its liability for Postage in the Hands of the Public (PIHOP).¹ To complete the hypothetical, there is \$800 of net

¹ Recall that the change in PIHOP liability equals Sales minus Breakage minus Usage.

Census revenue, and also \$210 of revenue estimated from the ODIS-RPW sample.² Of that \$210, as just noted, \$50 is associated with forever stamp usage, and therefore the other \$160 is not associated with forever stamps. The attached spreadsheet shows the steps needed to calculate product revenue, pieces and weight. In the upper portion of the first tab, which shows the current methodology, the process starts by calculating the BRAF that is applied to the ODIS-RPW estimates to ensure that, when added to census information, total reported RPW revenue equals trial balance revenue. The BRAF value of 0.95 (rounded) is applied to ODIS-RPW estimated revenue (forever and other products) and, when added to census, results in an aggregate estimated total trial balance of \$1,000.

Looking at the proposed methodology (the lower section of the first tab), we have an improved approach centered on the use of forever stamp usage revenue as a census input. Here, the \$50 of forever stamp usage is used directly (considered a census source) and only the other product revenue is BRAF adjusted. The proposed formulation also uses breakage directly (as a census source to be allocated to Other Revenue), and removes the \$5 PIHOP adjustment (census source previously). Adding the new census information totaling \$856, to the BRAF-adjusted ODIS-RPW estimated revenue of \$144, results in aggregate estimated total revenue of \$1,000 that must be reported in RPW.

The second tab of the spreadsheet provides more details on how these procedures affect the actual revenue, pieces and weight reported by product. One

² The \$800 of net Census revenue is the sum of \$805 of gross revenue from Census sources and the \$5 reduction of revenue resulting from the PIHOP adjustment, which for BRAF purposes is treated as Census revenue.

feature of the current methodology that this exercise highlights, for example, is that “allocation” of breakage to product in the current procedure is perhaps much more subtle than the Public Representative might have realized. Breakage in the current methodology affects the allocation to product only to the extent that it is an input into the calculation of PIHOP liability adjustment, which is then an input into the BRAF calculation, which ultimately does affect the revenue, pieces and weight reported by product. As shown, however, in the second tab of the illustration spreadsheet (specifically rows 12-17), even in the current methodology, the effects of breakage on products are far less direct than the effects of PIHOP. More fundamentally, the attached spreadsheet reinforces the necessary interdependence of all components of Proposal One.

The Public Representative appears to fail to appreciate the integrated nature of RPW reporting. The rejection of one component of the Proposal (removal of allocation of PIHOP adjustment to products) and the endorsement of another component (direct incorporation of usage data) would disrupt the RPW process. Furthermore, the integrated components are necessary not only to derive appropriate estimates of product revenue, pieces, and weight, but also to tie out to the trial balance revenue.

Similarly, her evaluation of breakage is misguided, and her analogy in that context to cost attribution analysis is misplaced. While her observation on page 2 correctly notes that product revenues are used to evaluate product cost coverages, that observation only underscores the importance of matching the correct costs with the correct volumes and revenues. In reality, however, the logic upon which she purports to rely with respect to breakage does not lead to achievement of that objective. She does

not dispute that breakage represents stamps that are purchased, but never used on any product. Her recommendation is that breakage nonetheless be allocated to specific stamped products because, in her view, breakage would not exist if the stamped products did not exist. PR Comments at 3. That tautology, however, should not determine whether it is sensible to attempt to allocate breakage to products.

Imagine a mailer who buys a sheet of stamps with every intention of using those stamps on First-Class Mail letters. If the stamps are misplaced and inadvertently discarded, they are never used even though the mailer contemplated using them when they were purchased. Thus, no First-Class Mail letters are ever tendered for delivery with those stamps. Consequently, there are no mailpieces associated with those stamps that should be included within the volume of First-Class Mail letters.

Furthermore, there are no costs associated with delivering pieces that do not exist.

The cost coverage evaluation referenced by the Public Representative needs to compare the costs of actual letters with the volume and revenue of actual letters. Treating the breakage as appropriately allocated to product, merely because we know that at some abstract level the existence of breakage is inextricably linked to the existence of stamped mail products, would confound the purposes of cost coverage evaluation, not advance them. Treating breakage in a manner that allows it to affect the specific volume and revenue estimates of specific mail categories (by inflating those estimates for forever pieces that never existed) is inappropriate, and Proposal One would properly eliminate that aspect of the current procedure.

Within the practical constraints under which all postal data systems must operate, the objective of the RPW system is to obtain the most accurate estimates

possible of revenue, pieces, and weight. The Postal Service indicated there are instances in which the current procedures appear to be failing in that objective and provided one example. See Proposal One at 8-9. The Proposal One procedures would remedy that deficiency. The Public Representative expresses what amount to no more than an abstract theoretical preference that allocations to product of certain components should be preserved. Yet the Public Representative makes no attempt to explain how the RPW estimates she seems to prefer would actually be constructed, or why preservation of the components upon which she has seized would actually produce more accurate estimates of revenue, pieces, and weight.³ For the reasons explained above, it would not.

Proposal One is a carefully integrated proposal that comprehensively deals with each aspect of the task at hand. The Commission should reject the Public Representative's attempts to extract certain components of the Proposal and evaluate them in a context independent of their actual role in the RPW process. Proposal One

³ In highlighting these limitations in the nature of the Public Representative's Comments, the Postal Service is not unaware of the difficulty inherent in evaluating proposals regarding a set of procedures as complex and as interrelated as those applicable to this Proposal. Potential sources of misunderstanding are varied and numerous, and it is challenging even for the Postal Service when preparing such a proposal to anticipate what feature might merit further explanation.

should be approved as submitted by the Postal Service.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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